

What Is Economics and Who Cares?

Economics is the study, description, and analysis of the ways in which societies produce and distribute *goods and services*. Economics can be applied to ancient civilizations—the Greeks and Phoenicians had economies—and to modern societies at the national, state, and local levels. For instance, California has the largest economy of any state, while New York City has the largest of any U.S. city. Even a household has an economy (although this does not cover “home economics”). Any system for deciding what is produced, how it is produced, and who gets to consume it, whether it is the system of an entire planet—as in the global economy—or a defined segment of society, is an economy and can be understood in economic terms.

Three Economists and Their Theories

The three most important economists were Adam Smith, Karl Marx, and John Maynard Keynes (pronounced *canes*). Each was a highly original thinker who developed economic theories that were put into practice and affected the world's economies for generations.

Adam Smith and His Invisible Hand of Capitalism

Adam Smith, a Scot and a philosopher who lived from 1723 to 1790, is considered the founder of modern economics. In Smith's time, philosophy was an all-encompassing study of human society in addition to an inquiry into the nature and meaning of existence. Deep examination of the world of business affairs led Smith to the conclusion that collectively the individuals in society, each acting in his or her own self-interest, manage to produce and purchase the goods and services that they as a society require. He called the mechanism by which this self-regulation occurs “the invisible hand,” in his groundbreaking book, *The Wealth of Nations*, published in 1776, the year of America's Declaration of Independence.

While Smith couldn't prove the existence of this “hand” (it was, after all, invisible) he presented many instances of its working in society. Essentially, the butcher, the baker, and the candlestick maker individually go about their business. Each produces the amount of meat, bread, and candlesticks he judges to be correct. Each buys the amount of meat, bread, and candlesticks that his household needs. And all of this happens without their consulting one another or without all the king's men telling them how much to produce. In other words, it's the free market economy in action.

In making this discovery, Smith founded what is known as classical economics. The key doctrine of classical economics is that a *laissez-faire* attitude by government toward the marketplace will allow the “invisible hand” to guide everyone in their economic endeavors, create the greatest good for the greatest number of people, and generate economic growth. Smith also delved into the dynamics of the labor market, wealth accumulation, and productivity growth. His work gave generations of economists plenty to think about and expand upon.

Keynes: The Government Should Help Out the Economy

Keynesian economics is an approach to economic policy that favors using the government's power to spend, tax, and borrow to keep the economy stable and growing.

John Maynard Keynes, a British economist and financial genius who lived from 1883 to 1946, also examined capitalism and came up with some extremely influential views. They were, however, quite different from those of Karl Marx and, for that matter, Adam Smith. In 1936, he published his *General Theory of Employment, Interest, and Money*. We will examine Keynes's theories later. They mainly involve people's propensity to spend or to save their additional money as their incomes rise, and the effects of increases in spending on the economy as a whole.

The larger significance of Keynes's work lies in the view he put forth about the role of government in a capitalist economy. Keynes was writing during the Great Depression. It's worth noting at this point that in the United States unemployment reached about 25 percent and millions of people had lost their life savings as well as their jobs. Moreover, there was no clear path out of the depression, which led people to seriously question whether Smith's invisible hand was still guiding things along. Was this worldwide collapse of economic activity the end of capitalism?

Keynes believed that there was only one way out, and that was for the government to start spending in order to put money into private-sector pockets and get demand for goods and services up and running again. As it turns out, President Franklin D. Roosevelt gave this remedy a try when he started a massive public works program to employ a portion of the idle workforce. However, the United States entry into World War II rendered this a less than pure experiment in government spending. The war effort boosted production to extremely high levels (to make guns, ammunition, planes, trucks, and other materiel) while simultaneously taking millions of men out of the civilian workforce and into uniform.

The validity and desirability of Keynes's prescription for a sluggish economy—using government spending to prime the pump—are still debated today. Again, we will look at the theory and practice of what came to be known as *Keynesian economics* later.

Many other economists of note advanced theories and otherwise added to the body of knowledge in the science. We will look at their ideas as they arise in our examination of economics. However, Adam Smith, Karl Marx, and John Maynard Keynes (later Lord Keynes) are widely recognized as the most influential—Smith because he founded and formalized the science of economics, Marx because he challenged capitalism and had such a forceful impact on society and politics, and Keynes because he prompted new practices as well as new theories in the world of economic policy. Keynes also played a key role in the founding of the International Monetary Fund and in other political economic measures taken at the end of World War II.